INVESTMENT CLIMATE STATEMENT

-- OPENNESS TO FOREIGN INVESTMENT

Since taking power in August 2008, the current Maoist-led Government of Nepal (GON) has signaled to foreign investors that Nepal is open for business. However, continuing bureaucratic delays and inefficiency, political instability, pervasive corruption, labor difficulties and persistent insecurity send a different message. At present, there are 1,570 foreign investment projects in Nepal, worth a total of approximately USD 2.13 billion, according to official GON statistics. With 414 ventures, India accounts for nearly 45 percent of total foreign investment. The 142 U.S. ventures rank second, accounting for 10.4 percent of total investment. China, South Korea, the United Kingdom and Norway are also prominent sources of foreign investment.

In 2005, the GON opened some service sectors to foreign investment. Progress has been made in allowing private operations in sectors that were previously government monopolies, such as telecommunications and civil aviation. Licensing and regulations have been simplified, and 100-percent foreign ownership is now allowed in some sectors. New banking institutions and a small stock exchange provide alternative sources of investment capital.

Nevertheless, significant problems remain. Basic infrastructure needed to support investment is woefully inadequate. The supply of power, especially outside of Kathmandu Valley, and water is insufficient. Transport is difficult, a problem compounded by the fact that Nepal is landlocked. (All products imported by ship enter through Kolkata, India, and are then shipped overland.) Nepal also lacks trained personnel and basic raw materials. Added to these challenges foreign investors face are the facts that tax administration is non-transparent and capricious, commercial legislation is inadequate and obscure, rules governing labor relations are vague and changeable, and obtaining a long-term visa is difficult. Furthermore, there is often a wide discrepancy between the letter of the law and its implementation.

Foreign investors constantly complain about complex and opaque government procedures and a working-level attitude that is more hostile than accommodating. Efforts intended to establish a "one window policy" and streamline government procedures related to foreign investment have produced few results. The GON has long been aware of the deficiencies in the investment climate and has slowly moving toward more investor-friendly arrangements. The Foreign Investment and Technology Transfer Act of 1992, for example, abolished the minimum capital investment requirement and eliminated other significant barriers to investment. The Act also allowed investment in legal, management consulting, accounting and engineering services, with a 51-percent limit on foreign ownership.

Policies regarding hydropower generation have changed to open the sector to private development, and the government is committed to revising the Electricity Act under which hydro-power generation licenses are granted. A policy intended to simplify the licensing procedure and to break the monopoly of the Nepal Electric Authority (NEA) over all aspects of generation, transmission and distribution was announced in October 2001. These changes were expected to boost the flow of foreign investment into the hydropower sector, but few have been implemented. The licensing process remains lengthy and cumbersome, and the government has not yet passed the legislation needed to unbundle the NEA’s functions and create an independent regulatory body.

A few sizable private-sector hydropower projects have either begun operation or are in the planning stages. However, unreasonable delay in evaluation of hydropower survey license applications, a poor security environment and political instability continue to discourage long-term investment in this sector. Private sector development of hydropower for export has also been limited by domestic politics and the government's inability to finalize a blanket electric power trade agreement with India, the only potential export market. A severe power shortage forced the government to declare an "energy crisis" in the country on December 17, 2008. To alleviate the power deficit, the Cabinet announced plans to set up diesel-powered “thermal plants” that would add 200 MWs to the national grid, but then backed off the plan following widespread protests. Subsequently however, the GON is currently considering scrapping certain regulatory requirements to expedite issuance of survey licenses to domestic and foreign private investors and to provide extra incentives, for at least for the next two years, to promote investment in hydropower projects.

Legislation

The most significant foreign investment laws are: the Foreign Exchange (Regulation) Act of 1962; the Foreign Investment and One Window Policy of 1992; the Foreign Investment and Technology Transfer Acts of 1992; the Immigration Rules of 1994; the Customs Act of 1997; the Industrial Enterprises Act of 1992; the Electricity Act of 1992; the Privatization Act of 1994 and the annual Finance Act that is passed every fiscal year, which outlines customs, duties, export service charges, sales, airfreight and income taxes, and other excise taxes that affect foreign investment.

The Foreign Investment and One Window Policy lists acceptable forms of investment, allows for foreign shares up to 100 percent in business areas not on its "negative list." establishes currency repatriation guidelines, and outlines visa arrangements, arbitration guidelines, and a special "one window committee" for foreign investors. The Foreign Investment and Technology Transfer Act (FITTA), which was revised in 1996, eliminated the minimum investment requirement and clarified rules relating to business and resident visas. In general, under the FITTA all agreements related to foreign investment are governed by Nepalese law and subject to arbitration in Kathmandu under United Nations Commission for International Trade Law rules. However, foreign law can be applicable in cases where the foreign investment exceeds 500 million rupees (approximately USD 7.9 million) and where the parties make this choice clear in their agreement.

The Immigration Rules of 1994 describe visa regulations. The Customs Act and the Industrial Enterprises Act, revised in 1997, established invoice-based customs valuations and eliminate many investment tax incentives, installing in their place a lower, uniform rate. The Electricity Act defines special terms and conditions for investment in hydropower development. The Privatization Act of 1994 authorizes and defines the procedures for privatization of state-owned enterprises to broaden participation of the private sector in the operation of such enterprises.

Additionally, the 1965 Patent, Design and Trademark Act and the 2002 Copyright Act define the terms and conditions of intellectual property rights protection. The Copyright Act, which covers all types of electronic audio and visual materials, provides for financial penalties, as well as imprisonment, and allows for the for confiscation unauthorized materials. Violators also have to pay compensation claimed by the copyright holder. However, the revised Copyright Act is not up to the level required for trade-related intellectual property rights by the World Trade Organization. Revisions are likely, as Nepal acceded to the WTO in April 2004.

Institutional Arrangements

The Department of Industry is designated as the "one window servicing agency," with the Industrial Promotion Board (IPB) as a focal point for foreign investment. The Department of Industry facilitates corporate registration, land transfers, utility connections, administrative services agreements, and coordination among various agencies. The Industrial Promotion Board (IPB), chaired by the Minister of Industry, is the primary government agency responsible for foreign investment. The IPB is charged with coordinating policy-level institutions, establishing guidelines for economic policy, approving foreign investment proposals, and determining applicable investment incentives. The Department of Industry (under the Ministry of Industry) registers and classifies foreign investments. It also serves as the secretariat for the "one window servicing agency," which manages the income tax and duty drawbacks granted to some foreign investments. However, on January 28, 2009, the GON introduced the “Investment Board Ordinance 2009”, which provisioned formation of a high level Investment Board under the chairmanship of the Prime Minister, and the Industry Minister as the ex-officio vice-chairman. Intended to function as a one-stop project clearance body, the new ordinance, which is currently pending with the cabinet, has authorized the Investment Board to approve any project proposals and monitor the progress on the activities of the projects.

Current administrative procedures do not allow for automatic approval of foreign investments. Foreigners are required to obtain licenses for manufacturing or service sector investments, and each license request must be considered individually. Investments below 1 billion rupees (approximately USD 13.2 million) are referred to the Department of Industry for action and are typically approved at the departmental level without the involvement of the IPB. However, investors frequently complain about bureaucratic delays and lack of transparency in procuring investment licenses. In most cases, one to six ministries other than the Ministry of Industry review a business proposal prior to consideration by the IPB.

The Department of Electricity Development, under the Ministry of Water Resources, is responsible for licensing all investments in hydropower projects. However, decisions on project proposals that involve foreign investment are invariably taken by the Ministry of Water Resources itself. Similarly, Nepal Rastra Bank (NRB), the country’s central bank, is responsible for issuing licenses to operate commercial banks and financial institutions. The Insurance Board (IB) is responsible for issuing licenses to operate insurance companies, both life and general. The Civil Aviation Authority of Nepal (CAAN) is responsible for granting operating licenses to both domestic and foreign airline operators, and the Nepal Telecommunications Authority (NTA) is responsible for issuing licenses for operating any type of telecommunications and information technology services.

Licensing of new investments is often time-consuming and requires a good lawyer and great patience. The IPB is mandated by law to make a licensing decision within 30 days of submission of an application, but this deadline is not generally met because of the legal proviso that all necessary information must have been submitted before a decision can be made. In practice, multiple meetings are usually required before the information is deemed sufficient.

Eligible Sectors

Foreign investment proposals must fall within eligible industry categories. These include: agriculture and forestry; manufacturing; electricity, both water and diesel-generated; construction; hotels and resorts; transport; communications; housing and apartments; and a restricted range of services. The GON opened service sectors, along with a few others, in

December 2005 in order to comply with its commitments. The newly opened sectors include business and management consulting, accounting, engineering and legal services, travel and trekking services, tourist lodging, international retail sales services, and production of alcohol or cigarettes. Foreign investment is forbidden in the defense sector, and the IPB will not license foreign investments that are judged to be either hazardous to general health or the environment.

Foreign investors are permitted to acquire real estate in the name of the business entity they own, but are not allowed to acquire real estate as personal property. Although local law permits foreign investors to buy shares on the local stock exchange, in practice investment in the stock exchange is not yet open to foreign investors. This is due mainly to the provisions of the Foreign Investment and Technology Transfer Act of 1992 which requires approval by the Department of Industry for a foreigner to buy shares in a Nepalese company. Also, in cases of investment in banks and insurance companies, prior approval of the regulator is required. Further, approval of Nepal Rastra Bank is also required for such purchase of shares under the Foreign Exchange (Regulation) Act 1962. All of these hurdles make investment in the local stock market unattractive to foreign investors.

Foreign investors are allowed to buy shares of government corporations by participating in the bidding for privatization of such corporations. In such cases, Nepal's Ministry of Finance sells the shares to the buyer after carrying out a lengthy screening during the bidding process. Through a July 2006 amendment in the licensing policy of financial institutions, the NRB increased the maximum foreign equity participation limit in domestic financial institutions to 85 percent from 67 percent. With the amendment, equity participation of foreign investors in joint venture financial institutions can range between 20 percent and 85 percent, with the remaining shares open for purchase by the general public. Joint venture financial institutions with less than 50 percent foreign equity participation are required to earmark at least 30 percent of their shares for sale to the general public.

The Privatization Act of 1994 generally does not discriminate between national and foreign investors. However, in cases where proposals from two or more investors are identical, the government gives priority to Nepali investors. To date 15 state-owned corporations have been privatized, seven corporations have been liquidated and two other corporations have been closed. The last privatization completed by the government was in January 2006. Out of the 15 corporations privatized so far, foreign investors have taken over two of them. The privatization process of three other state-owned corporations, which began in early 2006, was put on hold in April 2006. The current government, headed by the United Communist Party of Nepal (Maoist) and supported by the CPN-United Marxist Leninist, is in principal opposed to the privatization of state-owned corporations. Since coming to power in August 2008, the current government has not demonstrated any willingness to restart the privatization process. In fact, government ministers often express their support for reviving moribund state-owned corporations.

On April 13, 2004, the state-owned telecom operator, Nepal Telecommunications Corporation (NTC), was converted into a company and the name changed to Nepal Doorsanchar Company Limited (commonly known as Nepal Telecom), but ownership of the company remained entirely with the government. It is among few state-owned enterprises that have been earning good returns for years largely due to their historical monopolies. At the time of conversion of NTC into a company, the estimated amounts of paid-up capital and authorized capital of the corporation stood at 15 billion Nepali rupees (USD 238 million) and 25 billion Nepali rupees (USD 397 million) respectively. On January 23, 2008, Nepal Telecom launched an initial public offering (IPO) to sell 15 million shares, a 10-percent stake in the company. It also offered a 5-percent stake in the company, 7.5 million shares, to its employees as required by the government. The IPO fell well short of government expectations with the public purchasing roughly five million shares. In the budget speech in September 2008, the Finance Minister announced that the unsold shares will be sold through secondary markets.

Since 2003 the World Bank has been working to restructure two of the largest state-owned commercial banks, the Rastriya Banijya Bank ("National Commercial Bank" or RBB) and Nepal Bank Limited (NBL) to prepare them for privatization. However, the reform, revitalization, and professionalization of these institutions are long-term tasks, and the banks are not expected to be ready for privatization until late 2009 or 2010.

Visas

The GON offers different types of visas to investors and businesses. Potential investors are generally given six-month visas to conduct research and feasibility studies. To obtain a six-month visa, applicants must provide biographic information and a description of relevant work and professional experience. If the Department of Industry can readily identify the applicant as a legitimate business representative, the process can be expedited. Endorsement by a recognized foreign industrial enterprise is one means of accomplishing this. The Foreign Investment and Technology Transfer Act allows foreign investors to have one residential representative in Nepal. In cases where the foreign investor wishes to have more than one representative, the visa process becomes difficult. In the past, investors have even had problems obtaining visas for a second foreigner to serve as general manager responsible for their Nepalese operations.

Business visas are generally issued to approved investors for a period of one to five years. However, investors describe the business visa process as bureaucratic and time-consuming. Many say they spend more than 24 work hours per visa, over a period of 20 to 30 days.

Although the GON authorized the issuance of five-year, multiple-entry visas to resident foreign investors and their families in 1998, very few have been issued. In 1999, Nepal lowered its business visa fees; fees range from USD 250 for a five-year visa to USD 100 for a one-year visa. A non-tourist visa, however, costs USD $60 per month for the initial six-month period. This visa period can be extended for another six months or more at an additional $60 per month.

-- CONVERSION AND TRANSFER POLICIES

The Foreign Investment and Technology Transfer Act of 1992, permits foreign investors to repatriate all profits and dividends, all money raised through the sale of shares, all payments of principal and interest on any foreign loans, and any amounts invested in transferring foreign technology. Foreign nationals working in local industries are also allowed to repatriate 75 percent of their salaries, allowances, and emoluments, etc. Repatriation facilities (such as opening accounts or obtaining permission for remittance of foreign exchange) are made available on the recommendation of the Department of Industry, which normally provides approval of the original investment.

However, convertibility is difficult and not guaranteed. Repatriation of any funds needs approval from the relevant GON department and Nepal Rastra Bank, which regulates foreign exchange. In most cases, approval must be obtained from the Department of Industry. In other cases, such as telecommunications, the Nepal Telecommunications Authority must approve the repatriation. In joint venture cases, NRB and the Ministry of Finance must approve. Because commercial banks only process applications and do none of the oversight, the process slows down when it reaches the NRB, which must verify the authenticity of all requests. In the end, an overworked and inefficient banking system is to blame for slow approval of foreign exchange facilities. The actual experience of American and other foreign investors suggests that there are discrepancies between the government's stated policy of repatriation and its implementation.

To repatriate funds from the sale of shares, foreign investors apply to the NRB. For repatriation of funds connected with dividends, principal and interest on foreign loans, technology transfer fees, expatriate salaries, allowances, and emoluments, the foreign investor applies to the Department of Industry, and then to the NRB. At the first stage of obtaining remittance approval, foreign investors must submit remittance requests to a commercial bank. Generally, foreign investors rated services provided by private banks as satisfactory. However, final remittance approval must be made by the NRB foreign exchange department, at which stage the process slows down significantly. For this reason, foreign investors rated the Bank's administration of exchange regulations as unsatisfactory.

The Finance Act of FY 07/08 added, on an exceptional basis, a 5-percent tax on capital gains and an additional 5 percent to the existing tax on repatriation of foreign dividends.

In general, Nepalis are not permitted to invest outside of Nepal. Exceptions, however, can be granted on a case-by-case basis, and policing of the prohibition is weak. In 1995, a private airline was permitted to invest in a regional carrier based in Kolkata, however, the Nepalese airline stopped operation and closed down in 2005. The next year, another private airline operator formed a joint venture with a regional carrier based in India to operate flights in northeastern Indian states. These are the few instances of approved direct foreign investment by Nepalese nationals. During the peak of the Maoist insurgency in 2004 and 2005, a few industrial houses made unauthorized investments in India and Gulf countries.

-- EXPROPRIATION AND COMPENSATION

The Industrial Enterprise Act of 1992 states that "no industry shall be nationalized." The GON routinely reiterates this point in negotiations with private-sector firms interested in the hydropower sector. There have been no cases of nationalization in Nepal, nor are any anticipated.

Companies can be sealed or confiscated if they do not pay taxes in accordance with Nepali law. There are no official policies either existing or planned that suggest official expropriation should be of concern to prospective investors. There have been instances in the past in which unscrupulous local partners used the tax or regulatory systems to seize control of a joint venture firm from a U.S. investor. Such cases have not involved major Nepali business houses, however.

-- DISPUTE SETTLEMENT

In the event of a dispute with a foreign investor, the concerned parties are encouraged to settle it through mediation in the presence of the Department of Industry. If the dispute cannot be settled in this manner, cases involving investments less than NRS 500 million (approximately USD 6.5 million) in value will be referred to arbitration in Nepal in accordance with the Arbitration Rules of the United Nations Commission for International Trade Law (UNCITRAL). For investments that exceed this amount, the government of Nepal will permit stipulation of legal jurisdiction other than Nepal in shareholder agreements and contracts.

There have been two investment disputes over the past few years in which the GON did not honor portions of contracts with foreign investors. Coca-Cola Company has a pending tax dispute with the Department of Internal Revenue, and the Bhotekoshi Hydropower Company, which currently has only a 5-percent U.S. stake, has a pending payment dispute with Nepal Electricity Authority and the Ministry of Water Resources. Disputes have not been frequent, but investors should be aware that the GON may not fully comply with its contracts.

All real property transactions must be registered, and property holdings cannot be transferred without following established procedures. Even so, property disputes account for half of the current backlog in Nepal's overburdened court system, and such cases can take years to settle. Moreover, laws and regulations regarding property registration, ownership and transfer are unclear, and interpretation can vary from case to case.

Liquidation is covered by both the Company Act and the Insolvency Act of 2006. If a company is solvent, its liquidation is covered by the Company Act. If the company is insolvent and unable able to pay liabilities, or liabilities are more than assets, then its liquidation is covered by the Insolvency Act. Under the Company Act, the claimant priorities are: 1) government revenue; 2) creditors; and 3) shareholders. Under the Insolvency Act the government ranks with all other unsecured creditors. Monetary judgments are made in local currency.

Nepal is a signatory to and adheres to the New York Convention of 1958 on the recognition and enforcement of foreign arbitral awards, and it has updated its legislation on dispute settlement to bring its laws into line with the requirements of that convention. The Arbitration Act of 1999 allows the enforcement of foreign arbitral awards and limits the conditions under which those awards can be challenged.

-- PERFORMANCE REQUIREMENTS INCENTIVES

The Nepal Laws Revision Act of 2000 has eliminated most tax incentives, regardless of whether they were connected with performance requirements. Exports, however, are still favored, as is investment in certain "priority" industries. There is no discrimination against foreign investors with respect to export/import policies or non-tariff barriers. There is no local content or export performance requirement. There is no requirement that nationals own shares, that the share of foreign equity be reduced over time, or that technology be transferred. However, in the service sectors, which were opened in 2005, permitted foreign investment limits range from 51 to 80 percent; the balance of the investment is reserved for Nepali nationals in order to form a joint venture with a foreign investor. Foreign investment in cottage industries is still not allowed. The GON does offer tax incentives to encourage industries to locate outside the Kathmandu Valley due to pollution and overpopulation in the Valley and an interest in developing poorer parts of the country.

Profits from exports are taxed at 20 percent. Customs, value added tax (VAT), and excise duties on raw materials used in the production of export items are supposed to be reimbursed within 60 days. In practice, however, these duty paybacks are often extensively delayed. Although income in certain priority industries, such as garments, carpets and jewelry, used to be taxed at a concessional rate of 10 percent, the Income Tax Act 2002 removed most of these concessions.

The Electricity Act of 1992 governs foreign investments in hydropower generation. The Act exempts developers from income tax for the first 15 years of a project's operation and provides a flat 1-percent customs rate on all imported construction materials, equipment and spare parts, provided that such goods are not manufactured in Nepal.

Foreign investors are not required to disclose proprietary information to government agencies as part of the regulatory approval process. There are no restrictions on participation by foreign firms in government-sponsored research and development programs; however, depending upon the nature of the job and expertise required, government agencies sometimes limit such participation to Nepali nationals.

-- RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

Foreigners are free to establish and own business enterprises and engage in all forms of business activity with the exception of a few sectors. Foreign investment is prohibited in defense industries, real estate, and security printing. In addition, investment is restricted in some areas. For instance, foreign banks have not yet been allowed to open wholly-owned subsidiaries or branch operations in Nepal.

The GON is moving slowly toward open competition in most sectors of the economy. Former public monopolies in banking, insurance, airline services, telecommunications and trade have already been eliminated, and the remaining restrictions on private and foreign operations in other areas are being scaled back.

The Competition Promotion and Market Protection Act, which came into force in January 2007, defines anti-competitive practices and bars them. With the enactment of the law, tied selling, bid rigging, cartel formation, collective price fixing, market restrictions, dial-system, market segregation, undue business influences, syndicate, and exclusive dealing have now become illegal in the Nepal. The law also prevents companies from engaging in business takeovers which would help establish monopolies in the market. Sale of inferior quality goods has also been made punishable. To date, the law has been ineffective because the government has yet to establish the necessary enforcement mechanisms. The law was drafted through a joint initiative of the private sector and the then Ministry of Industry, Commerce and Supplies.

-- PROTECTION OF PROPERTY RIGHTS

The Contract Act of 2000 incorporates many new features, including provisions recognizing mortgages, sales, appointment of agents, and shipment of goods as contracts. Protection of intellectual property rights is inadequate. Patents registration, under the Patent, Design and Trademark Act of 1965, does not provide automatic protection to foreign designs and trademarks. Similarly, Nepal does not automatically recognize patents awarded by other nations. The Copyright Act of 2002 is similar in that it does not recognize foreign registrations. However, the Act covers most modern forms of authorship and provides adequate periods of protection. Enforcement is weak, with the result being that much of the software and most audio and visual video recordings now circulating in Nepal are pirated. As per the commitment made by the country on its accession to the World Trade Organization, Nepal must enact new legislation on trade-related intellectual property rights to bring the country into compliance with international norms. Nepal has not yet signed the World Intellectual Property Organization (WIPO) Copyright Treaty (WCT) or the WIPO Performances and Phonograms Treaty (WPPT).

Trademarks must be registered in Nepal to receive protection. Once registered, trademarks are protected for a period of seven years. Enforcement is very poor.

-- TRANSPARENCY OF THE REGULATORY SYSTEM

Foreign investors in Nepal must deal with a non-transparent legal system. Firms complain that basic legal procedures are neither quick nor routine. The bureaucracy is generally reluctant to accept legal precedents. As a consequence, businesses are often forced to re-litigate issues that had been previously settled. Furthermore, legislation banning foreign investment in financial, legal, and accounting services has made it difficult for investors to find help cutting through regulatory red tape.

Labor, health, and safety laws exist but are not properly enforced. Some companies report that the process of terminating unsatisfactory employees is cumbersome and that protective labor laws make it very difficult to bring skilled foreign-national specialists, such as pilots, engineers, and architects, into Nepal.

-- EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

Credit is generally allocated on market terms, although special credit arrangements exist for farmers and rural producers through the Agricultural Development Bank of Nepal. Foreign-owned companies can obtain loans on the local market. The private sector has access to a variety of credit and investment instruments. These include public stock and direct loans from finance companies and joint venture commercial banks.

Legal, regulatory, and accounting systems are neither fully transparent nor consistent with international norms. Though auditing is mandatory, professional accounting standards are low, and many practitioners are either poorly trained or lacking in business ethics. Under the circumstances, published financial reports are often unreliable, and investors are better advised to rely on general business reputations, except in the few cases in which companies have applied international accounting standards.

The Nepali banking system is small, fragmented, and, in some cases, plagued by bad loans. Banking system assets totaled approximately USD 9.19 billion as of mid-November 2008, while its capital (total deposits) totaled USD 5.71 billion. As of July 15, 2008, 6.08 percent of the total asset base was estimated as non-performing. Foreign commercial lending is scarce and expensive. Currently, there are no resident or non-resident foreign commercial banks that have standing credit limits for loans of a maturity of more than one year.

There is no regulatory system to encourage and facilitate portfolio investment in the industrial sector. Lack of transparency or regular reporting of reliable corporate information also presents problems for potential foreign investors. There are no legal provisions to defend against hostile takeovers. The GON has made certain exceptions to promote Foreign Direct Investment (FDI) in tourism and hydropower. In these sectors, there can be 100 percent foreign investment. The Clean Energy Development Bank (CEDB) has established a development fund of approximately US$ 3.2 million for funding feasibility studies of small and medium sized hydropower projects. The “Hydro Development Fund” will fill the early-stage financing gap for development of small- and medium-sized hydropower plants in Nepal.

-- POLITICAL VIOLENCE

From 1996 to 2006, Nepal suffered from a violent Maoist insurgency. The People’s Movement of April 2006, brought together the Communist Party of Nepal-Maoist (CPN-M) with the other major political parties of Nepal, popularly known as the Seven-Party Alliance (SPA), and ultimately compelled the King to end 15 months of direct rule. The parliament, which had been dissolved in May 2002, was reinstated. The restored parliament initiated a ceasefire with the Maoist rebels, stripped the King of most of his powers and launched a peace process that included the signing of a Comprehensive Peace Agreement (CPA), and the monitoring of the Nepal Army and the Maoist army and their weapons by unarmed UN observers under the United Nations Mission to Nepal (UNMIN).

In January 2007, an interim parliament was formed from members of the restored parliament and new members nominated by the CPN-M and the SPA. It approved the interim constitution and began preparations for the election of a constituent assembly (CA), which would be tasked with drafting a new constitution. In April 2007, the Maoists joined the interim government. That same month the CA election, which had been scheduled for June, was postponed. The next year was marked by on-again-off-again CA elections and the Maoist's withdrawal and return to the interim government. The CPN-M eventually agreed with the SPA to hold the CA election by April 2008, and it re-entered the government after the interim parliament agreed to make abolishment of the monarchy the first order of business at the initial meeting of the new CA.

Even with these agreements in place, the CA election was constantly at risk because of political divisions and the poor security, particularly in the Terai, the southern border region with India. While the ceasefire and CPA raised hopes nationwide, the early optimism quickly eroded. Political parties generally failed to respond to concerns of those living outside the Kathmandu Valley and certain segments of the population – including women, youth, lower castes, and ethnic minorities – were marginalized. Having little trust in the political process, splinter groups increasingly resorted to violence, which was exacerbated by the coalition government's inability to project a united front.

The historic Constituent Assembly election was finally held on April 10, 2008. The Communist Party of Nepal (Maoist) emerged as the largest party, securing 229 seats, and its leader formed a six-party coalition government in August 2008. The Maoists' principal partners are the CPN-UML and the Madhesi People's Rights Forum Nepal, the largest Terai-based party. The new government suffers from the same problem that hampered the interim government before the CA election: a lack of unity. Deep divisions exist not only between the coalition members but also within the individual parties themselves. As a result, the violence that marked the lead up to the election continues, and in some cases it has increased.

Tensions between the ethnic communities in the Terai, the central government and the Maoists, which led to deadly clashes with security forces in the months before the election, remain high. These communities are angered by their underrepresentation in new government. Numerous ethnic-based groups have been formed to demand greater recognition, many of which have vowed to use violence to obtain it. Widespread protests, demonstrations and strikes continue to plague the region.

Meanwhile, Maoists leaders have been unable – many people believe unwilling – to control the violent activities of its affiliated youth organization and trade unions, which continue to carry out extortion, kidnappings and other forms of intimidation, including murders. In an effort to counter the growing violence of the Maoist Young Communist League (YCL), the CPN-UML in 2008 created the Youth Force. Violent confrontations between the Maoists' youth wing and that of its largest coalition partner are common, and sometimes turn deadly. The YCL, recently renamed the Young Communist Democratic League (YCDL), however, has not limited its use of violence to its political rivals. It has also targeted the police, journalists and non-governmental organizations.

The risk of possible violence by the YCDL and Maoist-affiliated labor unions, as well as by Terai-based extremist groups, must be taken into account by any foreign firm wishing to invest in Nepal. The Department of State Travel Warning for Nepal, dated November 21, 2008, urges American citizens contemplating a visit to Nepal to obtain updated security information before they travel and to be prepared to change their plans at short notice. Given the nature, intensity and unpredictability of disturbances, American citizens are urged to exercise special caution during times when demonstrations are announced, avoid areas where demonstrations are occurring or crowds are forming, avoid road travel and maintain a low profile. All official travel outside the Kathmandu valley, including by air, requires specific clearance by the Regional Security Officer. As a result, emergency assistance to U.S. citizens may be limited. Active duty U.S. military and Department of Defense contractors must obtain a country clearance for official and unofficial travel to Nepal.

U.S. citizens who travel to or reside in Nepal are urged to register with the Consular Section of the Embassy by accessing the Department of State's travel registration site at https://travelregistration.state.gov or by personal appearance at the Consular Section, located at the U.S. Embassy, Maharajgunj, Kathmandu. The Consular Section can provide updated information on travel and security, and can be reached through the Embassy switchboard at (977) (1) 400-7200 or directly by fax (977) (1) 400-7281. Email: consktm@state.gov, web site: http://nepal.usembassy.gov.

U.S. citizens also should consult the Department of State's Consular Information Sheet for Nepal and Worldwide Caution Public Announcement via the Internet on the Department of State's home page at http://travel.state.gov or by calling 1-888-407-4747 toll free in the United States and Canada, or, for callers outside the United States and Canada, a regular toll line at 1-202-501-4444. These numbers are available from 8:00 a.m. to 8:00 p.m. Eastern Time, Monday through Friday (except U.S. federal holidays).

The U.S. Government's designation of the Communist Party of Nepal (Maoist) as a "Specially Designated Global Terrorist" organization under Executive Order 13224 and its inclusion on the "Terrorist Exclusion List" pursuant to the Immigration and Nationality Act remain in effect. These two designations make Maoists excludable from entry into the United States and bar U.S. citizens from transactions such as contribution of funds, goods, or services to, or for the benefit of, the Maoists.

-- CORRUPTION

U.S. firms and many other foreign investors have identified pervasive corruption as an obstacle to making, maintaining and expanding direct investment in Nepal. There are also frequent allegations of corruption by Nepalese government officials in the distribution of permits and approvals, in the procurement of goods and services, and in the award of contracts.

Combating corruption is the responsibility of the Commission for Investigation of Abuse of Authority (CIAA) and of the National Vigilance Center under the Ministry of Home Affairs. In the past -- and since Parliament's restoration in April 2006 -- the Parliamentary Public Accounts Committee has also played an active role in publicizing cases of misconduct on the part of GON officials. Since restoration of the multi-party system, the local media have been particularly active in unearthing and reporting cases of corruption within the government. Investigative commissions and committees are often formed to look into major cases of corruption that come to light. Officially, giving or accepting a bribe is a criminal act, punishable by imprisonment for one to six years, a fine, or both, depending on the degree of offense committed.

In the past the CIAA had been proactive in the prosecution of cases involving prominent political figures and government officials. In some cases, the Special Court has convicted the accused and, in at least one case, the convicted official is serving a jail sentence. Since the Chief Commissioner and another Commissioner retired in November 2006, the CIAA has been forced to function with only two Commissioners. In recent months CIAA's handling of the corruption cases has come under fire.   In June 2007 the CIAA filed a case against the Governor and one of the executive directors of Nepal's central bank, the Nepal Rastra Bank (NRB), for alleged misuse of funds. Critics claimed that the charges were without merit and perhaps brought at the behest of others to deter initiatives taken by NRB against bank defaulters.   In March 2008, the Supreme Court convicted the Governor and the Executive Director of NRB of corruption and imposed a fine of $ 51,538 on them. With the conviction, the two were stripped of their posts. Most of the high profile government ministers charged with corruption have, however, been acquitted by the Special Court.

The new interim constitution of Nepal has provisions to impeach the Chief Justice or other Judges for lack of competence, bad conduct, not fulfilling his/her responsibility honestly, and unable to perform his/her duty due to mental or physical condition. The accused judge is suspended from his/her job for the duration of the impeachment process. The judge will be automatically terminated form his/her job if such motion is passed by the parliament by a two-thirds' majority.

-- BILATERAL INVESTMENT AGREEMENTS

Nepal has signed bilateral investment treaties with Britain, Finland, France, Germany, India, Mauritius, and Norway.

-- OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

The Overseas Private Investment Corporation (OPIC) is free to operate in Nepal without restriction. OPIC is empowered to offer its "extended risk guarantee" facility to prospective U.S. investors in Nepal. Nepal is also a member of the Multilateral Investment Guarantee Agency (MIGA), which it joined in 1993.

The Export-Import Bank of the United States (Ex-Im Bank) is the U.S. Government's official export credit agency whose mission is to assist in financing the export of U.S. goods and services to international markets. Ex-Im Bank provides export credit insurance, loan guarantees and project and structured finance for U.S. exporters and foreign buyers of U.S. goods and services.

-- LABOR

Nepal lacks a large labor force of skilled and educated workers. The overall literacy rate is only 56.5 percent. Vocational and technical training are poorly developed, and the national system of higher education is overwhelmed by high enrollment. Many secondary and college graduates are unable to find employment in positions commensurate with their education because few schools and institutions provide job-related training. The employment of foreigners is severely restricted. Under current law, the Department of Immigration must approve the employment of foreigners for all positions except the most senior ones. In private organizations, however, a significant number of professionals from India may be found in mid-level managerial positions. Existing labor legislation is not seen as business friendly and dismissal of employees can be very problematic.

The Constitution provides for the freedom to establish and join unions and associations. It permits restrictions on unions only in cases of subversion, sedition, or similar conditions. Despite the institution of parliamentary democracy in 1990, trade unions are still developing their capacity to organize workers, bargain collectively, and conduct worker education programs. The three largest traditional trade unions are affiliated with political parties. Total union participation is estimated to be around one million, which accounts for only about 10 percent of the total labor force. Excluding agriculture labor, a much higher percentage of the formal sector participates in unions. The Maoists have an active affiliated trade union, All Nepal Trade Union Federation (ANTUF), which continues to engage in a series of disputes with management in various sectors and has been condemned for supporting illegal agitations in a number of large foreign joint ventures.

In 1992, Parliament passed the Labor Act and Trade Union Act, and formulated enabling regulations. However, the government has not yet fully implemented those laws. The laws permit strikes, except by employees in essential services such as water supply, electricity, and telecommunications. The laws also empowered the government to halt a strike or suspend a union’s activities if the union disturbs the peace or adversely affect the nation's economic interests, though, in practice, this is rarely done. Under the Labor Act, 60 percent of a union's membership must vote in favor of a strike in a secret ballot for the strike to be legal. The government does not restrict unions from joining international labor bodies. Several trade federations and union organizations maintain a variety of international affiliations. While officially there is no government interference in union registration, unions have complained of difficulties in registering members when opposing political parties are in power.

Frequent transportation and business closures (*bandhs*) called by political parties and other agitating groups have dramatically affected trade and industry. In 2007, labor and transport strife centered in the Terai forced the closure of businesses and halted transportation for up to 120 days in the hardest hit districts. Labor and transport strikes were also prevalent in 2008 although of a slightly lower rate. The Maoist-lead ANTUF has been aggressively trying to establish control in every industry and business sector. This has resulted in violent clashes between the members of ANTUF and the other trade unions. Several multinational companies, including the Coca-Cola Company, Colgate Palmolive and Unilever, have been forced over the past year to suspend operations or reduce production due to violent agitations, protests and persistent problem in importing raw materials and exporting their finished products.

In 2008, strikes and disruption of operation by labor increased significantly and were primarily targeted at foreign joint ventures and hotels. Beginning in January 2008, foreign investment companies like Coca Cola, Colgate Palmolive, Dabur Nepal, ITC, Unilever, and Indian telecom joint venture United Telecom Limited (UTL) were forced to stop operation repeatedly due to labor agitation. In January 2009, at least 500 factories in eastern districts Morang and Sunsari were forced to shut down due to protesting workers seeking pay hikes. On January 8, 2009, more than 200 hotels, and equal number of restaurants, tourist bus services and travel agencies in Pokhara, one of Nepal’s top tourist destinations, were forced to close over the issue of minimum wages raised by the Maoist affiliated trade unions, stranding hundreds of foreign tourists for days without any food or transportation.

The Child Labor Prohibition and Regularization Act of 2000 prescribe conditions for workers 14 to 16 years old and prohibit the employment of children under the age of 16 in dangerous industries. More recent legislation, including an act to combat trafficking in persons and the interim constitution, define children as persons under the age of 18. A number of existing laws affecting child labor are in need of harmonization.

-- FOREIGN TRADE ZONES/FREE TRADE ZONES

Nepal has no Foreign Trade Zones or Free Trade Zones. However, in its annual budget for FY 2008/09, the GON announced its intention to set up Special Economic Zones in 10 different places of Nepal, namely, Jhapa, Dhanusha, Birgunj, Dhangadhi, Bahiaraha, Nuwakot, Jumla, IT Zone in Banepa, Mahendranagar, and Panchkhal. An ordinance on Special Economic Zones is currently pending with the cabinet. Under the ordinance, an industry exporting 75 percent or more of its products would be entitled to apply for a space in a SEZ and import of raw materials and capital goods without payment of custom duties, excise taxes or sales taxes.

-- FOREIGN DIRECT INVESTMENT STATISTICS (AS OF DECEMBER 15, 2008)

Total No. of projects	1,570
Agriculture & Forestry	27
Manufacturing	601
Energy Based	32
Construction	39
Tourism	419
Mineral	16
Service	436
Total Project Cost:	USD 2,133.91million
Total Fixed Cost:	USD 1,779.58million
Total Foreign Investment:	USD 723.58 million

Total Employment Generated: 129,600

Source: Foreign Investment Division, Department of Industry, Nepal.

Note: As of December 15, 2008, India was by far the most important foreign investor in Nepal, with about 26.4 percent of the projects. It was also involved in five of the 10 largest foreign enterprises. In terms of total foreign investment, the United States is second; China, third; the South Korea, fourth; UK, fifth; Norway, sixth; and Japan, seventh.

-- U.S. INVESTMENT IN NEPAL (AS OF DECEMBER 17, 2008)

Total No. of projects	142
Agriculture and Forestry	4
Manufacturing	41
(9 units have either been cancelled or closed)	
Energy Based	1

Tourism Industry (2 units have been cancelled)	36
Service Industries	60

Total Project Cost: USD 238.32 million

Total Fixed Cost: USD 215.84 million

Total Foreign Investment: USD 81.64 million

Total Employment Generated: 11,331

Source: Foreign Investment Division, Department of Industry, Nepal.